



The Housing Crash and the Retirement Prospects of Late Baby Boomers

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Executive Summary

This paper extrapolates from data from the 2004 Survey of Consumer Finance to project household wealth, by wealth quintile, for the cohort that will be between the ages of 45-54 in 2009 under three alternative scenarios. The first scenario assumes that real house prices fall no further than their level as of March 2008. The second scenario assumes that real house prices fall an additional 10 percent as a 2009 average. The third scenario assumes that real house prices fall an additional 20 percent for a 2009 average. (Real house prices are currently falling at the rate of approximately 1.5 percent a month.)

The projections show that the vast majority of families in these age cohorts will have little or no wealth by 2009 in any of these scenarios. In the first scenario, families in the 45 to 54 age cohort in 2009, who were in the middle grouping of the wealth distribution in 2004, will have on average just \$113,600¹ of wealth in 2009, 26.2 percent less than families in this age group in 2004. In the second scenario, families in the middle quintile will have \$97,600 in wealth, 36.6 percent less than families in 2004. In the third scenario, families will have \$81,500, 47.0 percent less than families in the middle quintile for this age cohort in 2004.

Families in the second wealth quintile are projected to have just \$35,400 in wealth in 2009 under the first scenario and \$22,700 under the third scenario. Even families in the fourth wealth quintile are projected to have just \$250,200 in wealth in 2009 under the second scenario.

These projections show that the cohorts just approaching retirement will have very little to support themselves in retirement other than their Social Security. This means that any cuts in Social Security and Medicare below current levels are likely to impose serious hardships on all but the wealthiest families.

The projections also show that a large number of families in these age cohorts will have little or no equity in their homes in 2009. After deducting 6 percent for transactions costs, 13.7 percent of the homeowners who were in the middle wealth quintile will have negative net equity after selling their home in the first scenario. In the second scenario, 29.6 percent of the homeowners in the middle quintile would have negative equity after selling their home in 2009. In the second scenario, 32.2 percent of the homeowners in the second quintile will have negative equity after selling their homes in 2009. In total 21.6 percent of homeowners in the second scenario would have to pay money to sell their home in 2009.

Finally, the projections show that the renters within the same wealth quintiles in 2004 will have more wealth in 2009 than homeowners in all three scenarios. In the second and third scenarios, the renters will have dramatically more wealth in 2009 than the homeowners who started in the same wealth quintile. Homeownership is not everywhere and always an effective way to accumulate wealth. For those who owned a home in the last few years, the collapse of the housing bubble led to the destruction of much or all of their wealth.

¹ All dollar amounts in this paper are in 2004 dollars.

Introduction

Traditionally, Americans envisioned workers' income in retirement as a three-legged stool involving Social Security, a defined benefit pension and personal savings. In the last two decades, the share of the workforce with defined benefit pensions has fallen sharply so that this no longer is a substantial component of retirement income for most workers. Unfortunately, defined contribution and other personal savings have not come close to making up for this loss. The one asset that most middle-income families brought to retirement was their home, which in most cases was largely or completely paid off. Unfortunately, due to the rise and collapse of the housing bubble, this may not longer be the case.

The decline in house prices since the middle of 2006 has led to the loss of more than \$4 trillion in real housing wealth, more than \$50,000 for every homeowner in the country. Real house prices are now dropping at close to a 1.5 percent monthly rate, which translates into a loss of almost \$300 billion every month.

Just as economists were slow in recognizing the housing bubble, they have also been slow to recognize the importance of this loss in housing wealth. This extraordinary destruction of wealth will have enormous implications for the retirement security for tens of millions of families at or nearing retirement age.

This paper presents a brief analysis of wealth holdings of the cohort that will be between ages of the 45 and 54 in 2009, based on the data from the 2004 Survey of Consumer Finance (SCF), the most recent survey currently available.²

Wealth for Families Headed by People Between Ages 45-54: 2004 and 2009

Table 1 shows household wealth by income quintile for the families with a respondent between the ages of 45-54 in 2004, along with three separate projections for 2009. The first projection assumes that real house prices decline no further from the level reported in the March Case-Shiller 20-city index to their 2009 average.³ The second scenario assumes that real house prices in 2009 are on average 10 percent lower than they were in March of 2008. The third scenario assumes that real that real house prices in 2009, are on average, 20 percent lower than they were in March of 2008. (See the appendix for a full discussion of the methodology.)

While the assumption of a 10 percent price decline may seem extreme, with an assumption of a 20 percent decline even more extreme, it is important to note that house prices are currently falling at a real rate of close to 1.5 percent a month. Given the current rate of price decline, even if prices began to stabilize in the next few months, it is likely that prices would average at least 10 percent less in 2009 than their March 2008 level.

² The SCF is conducted every three years. Data from the 2007 survey will not be available until 2009.

³ Note that this would imply a nominal price increase between March of 2008 and 2009, since the assumption is that *real* prices do not change, which means that nominal prices must grow in step with inflation over this period.

TABLE 1
All Respondents

	Median	Mean	Mean By Quintile of 2004 Net Worth				
			Bottom	Second	Middle	Fourth	Top
2004							
Actual							
2003 Income	62,639	97,224	29,354	50,201	66,684	88,725	251,452
Has Defined Benefit Pension		35.0%	25.6%	35.6%	40.0%	44.7%	29.1%
Owns Primary Residence		76.4%	19.1%	77.7%	93.5%	94.9%	96.9%
Net Worth	150,520	555,003	3,061	57,153	153,967	357,487	2,206,378
<i>Note: With Negative Net Worth</i>		4.2%	21.0%	0.0%	0.0%	0.0%	0.0%
2009							
Scenario 1							
Net Worth	113,268	407,468	(782)	35,442	113,577	275,645	1,615,026
<i>Percent Change</i>	-24.7%	-26.6%	-125.6%	-38.0%	-26.2%	-22.9%	-26.8%
<i>Note: With Negative Net Worth</i>		6.5%	32.2%	0.3%	0.0%	0.0%	0.0%
Scenario 2							
Net Worth	98,400	383,219	(1,643)	29,060	97,561	250,160	1,542,451
<i>Percent Change</i>	-34.6%	-31.0%	-153.7%	-49.2%	-36.6%	-30.0%	-30.1%
<i>Note: With Negative Net Worth</i>		8.1%	35.0%	5.3%	0.2%	0.0%	0.0%
Scenario 3							
Net Worth	81,931	358,970	(2,503)	22,678	81,544	224,675	1,469,876
<i>Percent Change</i>	-45.6%	-35.3%	-181.8%	-60.3%	-47.0%	-37.2%	-33.4%
<i>Note: With Negative Net Worth</i>		10.0%	35.1%	11.1%	3.6%	0.2%	0.0%

Source: Survey of Consumer Finance and authors' calculations.

Note: All dollar amounts are in 2004 dollars.

For this reason, the assumption of a 10 percent further real decline in prices is a plausible middle scenario. The 20 percent real price decline shown in scenario 3 is undoubtedly pessimistic, but hardly implausible given the current rate of decline in house prices.

For simplicity, the calculations assume zero net savings over this period. This is a simplification, but savings out of disposable income has averaged less than 1.0 percent since the third quarter of 2004, when the last SCF was fielded, so an assumption of zero savings is not far from the average for the population as a whole over this period.⁴ The calculations assume that any stock holdings in 2004 rose in step with the S&P 500 over this period, with a further real rise of 3 percent assumed for 2009.

There was also no effort made to incorporate defined benefit pensions. The second line shows the share of each quintile in the age 45-54 cohorts reporting a defined benefit pension in 2004. It is almost certainly the case that if data were available on defined benefit pensions it would make the declines in wealth for the cohorts that will be in the age 45-54 range in 2009 larger relative to this group in 2004. The real value of assets in private sector defined benefit pension plans was 0.9 percent lower at the end of 2007 than in 2004. Given the 4.6 percent growth in the private sector workforce over this period,

⁴ This data can be found in the Commerce Departments' National Income and Product Accounts, Table 2.1, Line 34.

this translates to a decline of real assets per worker of 5.3 percent up to the end of 2007. Furthermore, younger workers, in general, are less likely to have defined benefit plans, so it almost certain that a smaller share of this age group in 2009 will have defined benefit pensions than did in 2004.⁵

Table 1 shows that in the first scenario, there is a decline in average household wealth of approximately \$148,000 (26.6 percent) from 2004 to 2009. The median household would lose 24.7 percent of its wealth; with a decline from \$150,500 in 2004 to \$113,300 in 2009. The declines are proportionately smaller moving up the wealth ladder, since housing wealth is a smaller share of total wealth for families with larger amounts of wealth. The second quintile is projected to lose 38.0 percent compared to the wealth for this quintile in 2004 (the bottom quintile is projected to have negative wealth in 2009), while the top quintile is only projected to lose 26.8 percent compared to the net worth for this quintile in 2004. The middle quintile in this scenario is projected to have \$113,600 in wealth in 2009.

The same pattern holds in the second and third scenario – those in less wealthy quintiles experiencing proportionately larger losses relative to wealth held by the same age cohort in 2004. The average loss of wealth in the second scenario is \$172,000, 31.0 percent of total wealth. The median loss is \$52,000, or 34.6 percent of total wealth in 2004. In this scenario, the average wealth for a household in the middle quintile is projected to be \$97,600 in 2009, a decrease of 36.6 percent from the 2004 level for this quintile.

In the third scenario, in which real house prices decline 20 percent from their March 2008 level, the average wealth loss is \$196,000 or 35.3 percent from 2004 levels. The loss of wealth for the median household in this age group between 2004 and 2009 is \$69,000, 45.6 percent of the 2004 wealth level. The average family in the middle quintile would have \$81,500 of wealth in this scenario, a drop of 47.0 percent from the wealth level for this quintile in 2004. In this scenario, the average wealth for a family in the second to the bottom quintile would be just \$22,700 in 2009.

Table 2 and **Table 3** illustrate the obvious point that the collapse of the housing bubble has led to huge losses for homeowners, while leaving the wealth of renters largely unaffected. (Some renters did lose wealth because they own homes which are not their primary residence.) The data for 2004, in the first line of both tables, show the relative wealth of the homeowners and renters within each wealth quintile. As can be seen, the homeowners within each quintile had considerably more wealth than renters.

This difference is largely eliminated or reversed in the first scenario, which assumes that real house prices do not decline further from their March 2008 level. The real wealth for a renter in the middle quintile in this scenario would be \$118,800 in 2009, while the real wealth for a homeowner in the middle quintile is projected to be just \$113,200, a decline of 27.3 percent from the 2004 level for homeowners between the ages of 45 and 54.

The relative benefits of renting rather than owning are even more striking in the second and third scenarios. The average home-owning family in the middle quintile in this age group in 2009 is projected to have 38.4 percent less wealth than did homeowners in this age group in 2004. They are projected to have 18.6 percent less wealth in 2009 than the average renter in the middle quintile, \$95,800 compared to \$117,700 for a renter in this quintile.

⁵ The private sector data can be found in the Federal Reserve Board's Flow of Funds Accounts, Table L.1118.b, Line 1. The rate of inflation shown by the CPI over this period was 10.4 percent.

TABLE 2
Respondent Owns Primary Residence

	Median	Mean	Mean By Quintile of 2004 Net Worth				
			Bottom	Second	Middle	Fourth	Top
2004							
Actual							
2003 Income	73,935	114,104	40,223	48,032	66,909	89,497	251,557
Has Defined Benefit Pension		37.7%	35.2%	35.1%	41.1%	46.0%	29.0%
Net Worth	229,610	700,667	11,333	59,193	155,660	359,586	2,213,738
<i>Note: With Negative Net Worth</i>		0.0%	0.8%	0.0%	0.0%	0.0%	0.0%
<i>Note: Owner Needs Cash to Close at Home Sale</i>		3.3%	27.1%	6.8%	1.9%	0.1%	0.5%
2009							
Scenario 1							
Net Worth	188,638	531,981	(5,249)	36,549	113,130	274,451	1,606,881
Percent Change	-17.8%	-24.1%	-146.3%	-38.3%	-27.3%	-23.7%	-27.4%
<i>Note: With Negative Net Worth</i>		1.7%	54.6%	0.4%	0.0%	0.0%	0.0%
<i>Note: Owner Needs Cash to Close at Home Sale</i>		10.9%	59.8%	20.1%	13.7%	4.9%	2.2%
Scenario 2							
Net Worth	170,256	499,642	(12,958)	27,403	95,823	248,497	1,534,351
Percent Change	-25.9%	-28.7%	-214.3%	-53.7%	-38.4%	-30.9%	-30.7%
<i>Note: With Negative Net Worth</i>		3.9%	80.2%	7.6%	0.2%	0.0%	0.0%
<i>Note: Owner Needs Cash to Close at Home Sale</i>		21.6%	71.8%	32.2%	29.6%	13.1%	9.3%
Scenario 3							
Net Worth	143,632	467,303	(20,668)	18,257	78,516	222,544	1,461,820
Percent Change	-37.4%	-33.3%	-282.4%	-69.2%	-49.6%	-38.1%	-34.0%
<i>Note: With Negative Net Worth</i>		6.5%	81.2%	16.0%	3.9%	0.2%	0.0%
<i>Note: Owner Needs Cash to Close at Home Sale</i>		31.9%	79.2%	50.6%	41.7%	20.6%	15.1%

Source: Survey of Consumer Finance and authors' calculations.

Note: All dollar amounts are in 2004 dollars.

In the third scenario, the average homeowner in the middle quintile is projected to have 49.6 percent less wealth in 2009 than did a homeowner in this age group in the middle wealth quintile in 2004. In this scenario, an average homeowner in the middle quintile would only have 67.3 percent as much wealth in 2009 as a renter in the same age group who started in the same wealth quintile.

The last line in each scenario in Table 2 (above) shows the percentage of homeowners who would have negative housing equity after deducting 6 percent transactions costs from the current value of their home. This number is effectively the percentage of homeowners in each wealth quintile who would have to bring a check to the closing of their home sale.

TABLE 3
Respondent Does Not Own Primary Residence

	Median	Mean	Mean By Quintile of 2004 Net Worth				
			Bottom	Second	Middle	Fourth	Top
2004							
Actual							
2003 Income	30,806	42,569	26,793	57,778	63,462	74,291	248,188
Has Defined Benefit Pension		26.1%	23.3%	37.3%	23.9%	19.7%	32.5%
Net Worth	4,500	83,374	1,112	50,025	129,673	318,278	1,978,096
<i>Note: With Negative Net Worth</i>		17.7%	25.7%	0.0%	0.0%	0.0%	0.0%
2009							
Scenario 1							
Net Worth	5,050	67,760	(233)	32,965	118,759	317,176	1,847,031
Percent Change	12.2%	-18.7%	-120.9%	-34.1%	-8.4%	-0.3%	-6.6%
<i>Note: With Negative Net Worth</i>		19.5%	29.4%	0.0%	0.0%	0.0%	0.0%
Scenario 2							
Net Worth	5,050	65,583	(250)	32,768	117,698	307,970	1,773,187
Percent Change	12.2%	-21.3%	-122.5%	-34.5%	-9.2%	-3.2%	-10.4%
<i>Note: With Negative Net Worth</i>		19.5%	29.4%	0.0%	0.0%	0.0%	0.0%
Scenario 3							
Net Worth	5,050	63,405	(267)	32,572	116,637	298,764	1,699,343
Percent Change	12.2%	-24.0%	-124.0%	-34.9%	-10.1%	-6.1%	-14.1%
<i>Note: With Negative Net Worth</i>		19.5%	29.4%	0.0%	0.0%	0.0%	0.0%

Source: Survey of Consumer Finance and authors' calculations.

Note: All dollar amounts are in 2004 dollars.

In the second scenario, 29.6 percent of the homeowners who were in the middle wealth quintile in 2004 would have to bring a check to their closing in 2009. Almost 72 percent of homeowners who were in the bottom wealth quintile would have to bring a check to their closing in 2009.

In the third scenario, 31.9 percent of all homeowners in the cohort from age 45 to 54 in 2009 would have to bring a check to their closing. For homeowners who were in the middle wealth quintile in 2004, the share who would need to bring a check to their closing would be 41.7 percent. The share of the homeowners who were in the fourth wealth quintile in 2004 would be 20.6 percent. For homeowners in the bottom wealth quintile in 2004, 79.2 percent would have to pay money to sell their house in 2009.

Implications for Policy

The plunge in wealth that most families are projected to see as a result of the collapse of the housing bubble should emphasize once again the potential danger of such bubbles. There are two reasons that these families see sharp declines in their wealth over this period. The most obvious reason is the loss in the real value of their home, their major financial asset.

However, there is a second important factor that also leads to a decline in wealth for this age cohort between 2004 and 2009. As a result of the bubble-inflated values of their homes, tens of millions of families opted not to save during what would typically be their peak saving years. The age cohort that will be age 45 to 54 in 2009 was between the ages of 40 and 49 in 2004. Ordinarily these are peak saving years in which families add considerably to their lifetime wealth.

By assumption, families in these projections did not save during this period, reflecting the near zero level of savings nationally. This assumption will of course not be exactly accurate, although it is not clear in which direction the error will go. The families in this age cohort are disproportionately homeowners and, therefore, more likely than the population as a whole to have not saved or borrowed based on the equity in their home. In short, it is entirely possible that the homeowners in this group engaged in dis-saving over this period, as they were content to allow the bubble driven build-up of wealth in the form of home equity to substitute for savings out of disposable income.

Whatever turns out to be the case about the actual behavior of the homeowners in this age cohort, the basic point is the straightforward. Workers have a limited number of years during their lifetime in which they can accumulate wealth toward retirement. If they save little or nothing during a substantial portion of these years because they expect wealth generated by a bubble to persist and grow further, then they are likely to find themselves ill-prepared for retirement when the bubble bursts.

These projections should highlight the importance of policies that combat financial bubbles. The policy of the Fed during the last decade, that financial bubbles should just be left to run their course, virtually guarantees that tens of millions of people will reach retirement with little or nothing to support themselves in retirement other than their Social Security.

The other point that should be apparent from these projections is that proposals for substantially cutting back Social Security and Medicare for those approaching retirement are unrealistic given the financial situation of those near retirement. In the second scenario, families in the middle quintile will have just \$97,600 in wealth in 2009. Even if this sum were fully annuitized (implying that they maintained no equity in a home), it could provide only a very modest supplement to their Social Security benefits.

Families in the second wealth quintile are projected to have an average of just \$29,000 in wealth in 2009 in the second scenario. Even families in the fourth quintile are only projected to have \$250,000 in wealth in 2009 in this scenario. Of course, the third scenario implies even less wealth. In this scenario, families in the middle wealth quintile are projected to have just \$81,500 of wealth in 2009 and families in the second quintile are projected to have just \$22,700 of wealth.

In short, as a result of the collapse of the housing bubble, the vast majority of late baby boomers will be approaching retirement with little wealth outside of Social Security. While they will still have some opportunities to accumulate wealth in the years until they retire, it is unlikely that the picture will be very different after relatively small number of additional work years. This means that cutting back Social Security and Medicare from current levels will impose serious hardships on this age group.

Finally, these projections should make clear that homeownership is not always an effective way to accumulate wealth. Homeownership in a housing bubble was a route toward losing wealth, not accumulating wealth. While typical homeowners cannot be blamed for not recognizing the bubble, the

economists and policy professionals who designed policies that pushed homeownership certainly can and should be blamed.

It was possible to recognize a bubble at least as far back as 2002 based on the sharp divergence in house prices from their historic trend.⁶ The fact that so many economists and policy professionals failed to recognize and warn of this bubble had enormous consequences. Unfortunately, the people who listened to these experts are likely to suffer the consequences of the experts' failure, rather than the experts themselves.

⁶ Baker, D. 2002. "The Run-Up in House Prices: Is It Real or Is It Another Bubble?" Washington, D.C.: Center for Economic and Policy Research. Available online at: [<http://www.cepr.net/index.php/publications/reports/the-run-up-in-home-prices-is-it-real-or-is-it-another-bubble/>].

Appendix

Estimates and Projections Based on the 2004 SCF

Estimates of assets and debts by households in 2004 come from the 2004 Survey of Consumer Finances based on the SAS program provided by the Federal Reserve.⁷ The only significant change to the original program was to split net equity in nonresidential real estate into corresponding assets and debt.

Projections of assets and debts by household in 2009 were made from adjusted equity and real estate values. Equity values were adjusted by the inflation-adjusted S&P 500 from September 2004 to March 2008 (7.33 percent), plus 3 percent for 2008 to 2009 (10.55 percent total.) Real estate prices were adjusted by the Case-Shiller 20-city Composite Index over the same period (-10.3 percent), but with 2009 adjustment based on three scenarios. (0, -10, and -20 percent from 2008 to 2009.)

⁷ Available online at: [<http://www.federalreserve.gov/PUBS/oss/oss2/bulletin.macro.txt>]